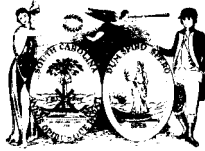


State of South Carolina



Office of the State Auditor

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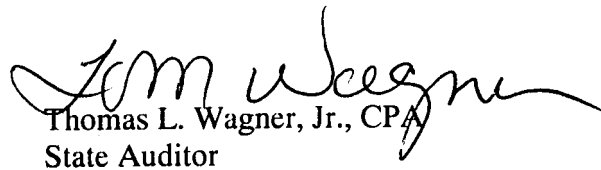
October 25, 2002

The Honorable Jim Hodges, Governor  
and  
Members of the South Carolina State Budget and Control Board  
Columbia, South Carolina

This report on the audit of the financial statements of the South Carolina State Budget and Control Board Office – Employee Insurance Programs for the fiscal year ended June 30, 2002, was issued by DeLoach & Williamson, L.L.P., Certified Public Accountants, under contract with the South Carolina Office of the State Auditor.

If you have any questions regarding this report, please let us know.

Respectfully submitted,

  
Thomas L. Wagner, Jr., CPA  
State Auditor

TLWjr/trb

**SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAMS**

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**AUDITED FINANCIAL STATEMENTS  
AND OTHER FINANCIAL INFORMATION**

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**YEAR ENDED JUNE 30, 2002**

**WITH**

**REPORT OF INDEPENDENT AUDITORS**

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAMS

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AUDITED FINANCIAL STATEMENTS  
AND OTHER FINANCIAL INFORMATION

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YEAR ENDED JUNE 30, 2002

WITH

REPORT OF INDEPENDENT AUDITORS

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**REPORT OF INDEPENDENT AUDITORS**

Mr. Thomas L. Wagner, Jr., CPA  
State Auditor  
State of South Carolina  
Columbia, South Carolina

We have audited the accompanying basic financial statements of the South Carolina State Budget and Control Board, Employee Insurance Programs (the "Fund") as of and for the year ended June 30, 2002, as listed in the table of contents. These financial statements are the responsibility of the management of the South Carolina State Budget and Control Board, Employee Insurance Programs. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in *Note 1*, the accompanying financial statements of the South Carolina State Budget and Control Board, Employee Insurance Programs are intended to present the financial position and results of operations of its governmental and proprietary fund types and cash flows of its proprietary fund type of only that portion of the funds of the State of South Carolina that is attributable to the transactions of the funds of the South Carolina State Budget and Control Board, Employee Insurance Programs.

As discussed in *Note 19*, prior to the current fiscal year, the Fund incurred operating losses for four of the previous five years which has resulted in a significant retained deficit. See *Note 19* for additional information.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the funds of the South Carolina State Budget and Control Board, Employee Insurance Programs, as of June 30, 2002, and the results of operations of its governmental and proprietary fund types and cash flows of its proprietary fund type for the year then ended in conformity with accounting principles generally accepted in the United States of America.

We also audited the adjustments described in *Note 18* that were applied to restate the 2001 financial statements. In our opinion, such adjustments are appropriate and have been properly applied.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 25, 2002, on our consideration of the Fund's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

The Management's Discussion and Analysis and the Statement of Expenditures-Budget and Actual-All Budgeted Funds are not a part of the basic financial statements, but is supplementary information required by the *Governmental Accounting Standards Board* (GASB). Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements, and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

*DeLoach & Williamson, L.L.P.*

September 25, 2002

## **Management's Discussion & Analysis**

This section of the South Carolina State Budget and Control Board, Employee Insurance Program (EIP) Audited Financial Statements and Other Financial Information presents management's discussion and analysis of EIP's financial performance during the fiscal year ended June 30, 2002. This discussion should be read in conjunction with the financial statements and the notes, which follow this section.

This is the first year of implementation of Governmental Accounting Standards Board (GASB) Statement No. 34, Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments. The financial statement presentation required by GASB Statement 34 provides a comprehensive perspective of EIP's assets, liabilities, net assets, revenues, expenses, changes in net assets, and cash flows.

### **Financial Highlights:**

- Business-Type Activities reported a change in net assets of \$3,129,299 for the year ended June 30, 2002 and negative net assets of \$69,614,594 at year end.
- Governmental Activities (Senior Drug Program) reported a change in net assets of \$2,956,526 for the year ended June 30, 2002 and positive net assets of \$5,662,478 at year-end.
- Combined Business-Type Activities and Governmental Activities reported a change in net assets of \$6,085,825 for the year ended June 30, 2002 and negative net assets of \$63,952,116 at year end.

### **Overview of Financial Statements:**

The Employee Insurance Program is an internal service fund proprietary type engaged primarily in Business-Type Activities. EIP also administers the SilverCard program, a Governmental Activity. Following is a condensed Statement of Net Assets and a condensed Statement of Revenue, Expenses, and Changes in Net Assets and a condensed Statement of Cash Flows.

The Statement of Net Assets presents the financial position of EIP at the end of the fiscal year and requires classification of assets and liabilities into current and noncurrent categories. The difference between total assets and total liabilities is reflected in the net assets section, which displays net assets in three categories: invested in capital assets (net of related debt), restricted, and unrestricted. Net assets are one indicator of the current financial condition of EIP, while the change in net assets is an indicator of whether the overall financial condition has improved or worsened during the year.

The Statement of Revenues, Expenses, and Changes in Net Assets present revenues and expenses as operating and are detailed by classification.

The Statement of Cash Flows will aid readers in identifying the sources and uses of cash by the categories of operating, capital and related financing, non-capital financing, and investing activities.

**Financial Analysis of EIP:**

This schedule is a condensed version of EIP's assets, liabilities, and net assets and is prepared from the Statement of Net Assets.

**Net Assets  
as of June 30, 2002  
(In millions)**

	<b>Governmental Activities</b>
Current assets	\$ 73.6
Non-current assets	21.3
Total assets	<u>94.9</u>
Current liabilities	158.7
Non-current liabilities	0.2
Total liabilities	<u>158.9</u>
Net assets	
Restricted:	
Senior Drug Program	5.6
Investment in capital assets	-
Unrestricted	<u>(69.6)</u>
Total net assets	<u><u>\$ (64.0)</u></u>

The EIP's net assets have been restated as of July 1, 2001 due to a change in the capitalization level of assets. The details are reflected in *Note 18*, Restatement, of the accompanying notes to the financial statements.

The following schedule is a summary of the EIP's operating results for the fiscal year.

**Statement of Revenue, Expenses,  
and Changes in Net Assets  
(Proprietary Fund)  
(In millions)**

Operating revenue

Insurance Premiums

Active employee	\$ 831.6
Retirees	211.8
Other premium revenue	9.3
Total operating revenue	<u>1,052.7</u>

Operating expenses

Premiums	99.1
Claims	920.8
Administrative	33.3
Total operating expenses	<u>1,053.2</u>

Operating income (loss)	(0.5)
Adjustments	3.6
Net income (loss)	<u>3.1</u>

Net assets, beginning of year	<u>(72.7)</u>
Net assets, end of year	<u><u>\$ (69.6)</u></u>



**Statement of Revenues, Expenditures,  
And Changes in Fund Balances  
(Governmental Fund)  
(In millions)**

Revenue:	
Tobacco settlement	\$ 17.3
Investment earnings	6.7
Other	0.2
Total revenue	<u>24.2</u>
Expenditures:	
Administrative fees	0.3
Claims expenses	21.0
Total expenditures	<u>21.3</u>
Excess of revenue over expenditures	2.9
Other financing sources	0.1
Excess of revenue and other financing sources over expenditures and other financing uses	<u>3.0</u>
Fund balance, beginning of year	<u>2.7</u>
Fund balance, end of year	<u>\$ 5.7</u>

**A condensed version of Statement of Cash Flows is presented as follows:**

**Condensed Statement of Cash Flows**  
**(Proprietary Fund)**  
**(In millions)**

Cash Flows from Operating Activities	\$ 15.5
Cash Flows from Capital and Related Financing Activities	
Cash Flows from Noncapital Financing Activities	(0.7)
Cash Flows from Investing Activities	<u>1.9</u>
Net increase in cash and cash equivalents	<u>16.7</u>
Cash and cash equivalents, beginning of year	<u>27.7</u>
Cash and cash equivalents, end of year	<u><u>\$ 44.4</u></u>

Comparative information of the condensed financial information derived from the financial statements is required under GASB 34; however, a reprieve of this comparative information has been granted during the implementation year. Comparative information will be presented when multiple years of data has been captured.

## **Overview of EIP:**

The Employee Insurance Program manages group health, dental, life, accidental death and dismemberment and disability programs as authorized in § 1-11-710 and § 1-11-720 of the South Carolina Code of Laws. Also managed by EIP is the long-term care program as authorized in § 1-11-740 of the South Carolina Code of Laws.

Following is a table of benefits offered by EIP. The benefits are differentiated according to self-insured versus fully insured products.

### Self-Insured Programs

State Health Plan (medical, prescription drug, and behavioral health)  
MUSC Options (HMO)  
Upstate Partners (HMO)  
State Dental Plan  
Basic Long Term Disability

### Fully-Insured Programs

Companion Healthcare (HMO)  
Dental Plus  
State Life  
Optional Life  
Dependent Life  
Long Term Care  
Supplemental Long Term Disability

Benefits are offered to eligible employees and retirees of State agencies, school districts, local governments, and other enterprises. The State Health Plan is the significant driver of EIP's financial activity, accounting for over 90% of all revenue. Premium revenue is shared between the employer and the enrollee. For 2002, this split was 81% employer and 19% enrollee. A discussion of the Senior Drug Program is included at the end of the Management's Discussion and Analysis.

Following is a look at total enrollment in the State's insurance programs and the enrollment in the State Health Plan.

	<u>Program</u>	<u>State Health Plan</u>
<b>Total Insured Persons:</b>	<b>414,075</b>	<b>379,507</b>
Subscribers:	233,362	212,712
Spouses:	64,375	60,568
Children:	116,338	106,227
<b>Total Subscribers:</b>	<b>233,362</b>	<b>212,712</b>
Employees:	175,736	156,060
Retirees:	53,120	52,282
Survivors	2,701	2,679
COBRA	1,805	1,691
<b>Active Employees:</b>	<b>175,736</b>	<b>156,060</b>
State Agencies:	65,339	56,645
School Districts:	77,707	71,670
Local Governments:	26,512	23,452
Enterprises:	6,178	4,293

A short historical review of the State Health Plan's financial experience on a Plan Year basis (January through December) indicates five consecutive years of net losses, preceded by seven consecutive years of net gains. Even without rate increases in each of Plan Years 1994, 1995, and 1996, Plan income exceeded expenses. For Plan Years 1997 and 1998, contributions remained constant, with the expectation of operating losses. These losses were "planned" to spend down or reduce accumulated cash reserves, at the direction of State budget writers, because even with losses, cash reserves were expected to remain within statutory parameters. Beginning in Plan Year 1999, claims expenses began to surge unexpectedly. This dramatic change in claims trend was not unique to the State Health Plan, but rather one that was experienced throughout the health insurance industry.

The State's budget process calls for budget requirements for the upcoming calendar year to be estimated at the outset of the prior year. Because of this timing, 2000 contribution rates were estimated and 1999 rates already established based on 1998 claims data, not knowing that the surge was about to occur.

Following is a look at employer and enrollee contribution increases which have been implemented since Plan Year 1999.

	<u>Employer</u>	<u>Enrollee</u>
1999	18.00%	no increase
2000	10.00%	no increase
2001	20.00%	\$5/subscriber/month
2002	9.50%	\$12/subscriber/month

In addition to annual contribution increases, material provider reimbursement cuts and reductions in benefits were implemented for Plan Years 2000 and 2001, respectively. Despite provider cuts and benefit reductions, claims trend continues to rise. Analysis of Plan payout growth per person during the period 1994 through 1998 averaged 5.3%. In 1999, the payout growth reached 8.9%, and 2001 data estimates growth at 11.3%. Prescription drugs are responsible for roughly half of the growth in expense from 1997 through 2001. With the exception of prescription drugs and physician office visits, payment per service episode has either declined or remained virtually static. Even so, payments for these services are increasing as well, because of service volume growth. The Plan is also experiencing accelerated claims growth in certain disease categories in comparison to others and prescription drug expense continues to balloon. Prescription drugs accounted for 23% of total claims expense in 2001 compared to 13% in 1997. The growth in prescription drugs is attributed to the substantial increase in users per enrollees, prescriptions per enrollee, and cost per prescription. A major factor driving this growth the result of heavily marketed drugs by the pharmaceuticals. These marketed drugs account for the highest State Health Plan volume.

#### **State Health Plan 2002 Initiatives:**

Several State Health Plan cost containment initiatives were implemented during Plan Year 2002. One initiative includes the “Blue Card” program, in which the Plan benefits from local Blue Cross and Blue Shield provider contracting arrangements throughout the country. Blue Card is expected to garner the most savings for the Plan (approximately \$5M. annually). Other initiatives include complex case management designed to assist the sickest Plan members in healthcare decision making and new disease management programs geared towards educating and promoting health care compliance for members living with chronic diseases. A provider-profiling project is also under way, in which claims data is analyzed in an effort to identify cost effective providers. This data will be useful in the event the State elects to develop and implement a restrictive provider network made up of providers with “best practices”. Prescription drug initiatives for 2002 included a generic “pay-the-difference” policy which limits Plan payments for brand drugs to their generic equivalent and a voluntary mail service pharmacy, providing shared savings between the Plan and the member. In addition, prescription drug co-payments were increased by \$2/prescription for 2002 and the annual co-payment maximum was raised to \$1,100/person.

### **State Health Plan 2003:**

§ 1-11-710 (A) (2) of the South Carolina Code of Laws requires that the Budget and Control Board approve by August 15, the State Health Plan benefits and contributions for the upcoming year. No new employer funding was appropriated for Plan Year 2003. \$24, per subscriber, per month in Plan “impact” was deemed necessary in order to maintain a zero reserve balance during 2003. Proviso 63.15 eliminated any reserve requirement for the Plan in 2002 and 2003. This proviso stipulates “Notwithstanding any other provision of law, the State Health Plan is only required to seek a zero day reserve fund by the end of calendar year 2002.” After consulting with participants and stakeholder groups, it was determined that this impact be achieved entirely through an increase in enrollee contributions, without changes to the Plan of Benefits. Effective January 2003, the State Health Plan will increase enrollee contributions an average of \$24/subscriber/month.

### **Senior Drug Program:**

The Senior Drug Program (SilverCard) continues to be administered by the Employee Insurance Program. This program provides financial assistance for purchasing prescription drugs to senior citizens who are ineligible for or do not have prescription drug coverage or other assistance through federal, state, or private programs. The Senior Drug Program is funded through direct appropriations. These funds were received by the State in the settlement agreement and related documents, between the State and leading US tobacco manufactures dated November 23, 1998. The fiscal year 2001-2002 budgeted amount for the Senior Drug Program was \$24M. Expenditures were within budgeted projections for the Senior Drug Program. Proviso 63.18 allows a carry-forward of Senior Drug Program funds from one fiscal year to the next. Effective July 1, 2002 the Silver Card Program was transferred from EIP to Health and Human Services.

### **Capital Asset and Debt Administration:**

Due to a change in the capitalization threshold mandated by the Comptroller General’s Office of the State of South Carolina, a restatement of net assets was required. This restatement resulted in a reduction in asset cost of \$637,005 and a reduction in accumulated depreciation of \$156,559. In addition the EIP purchased \$39,402 in fixed assets funded through operational revenues. Also, \$147,245 in fixed assets was transferred to the Insurance Reserve Fund as part of the reorganization that occurred July 1, 2001. The EIP has no debt outstanding as of year-end.

### **Reorganization:**

In early 2002, the South Carolina Budget and Control Board reorganized the Employee Insurance Programs. This reorganization, however, did not become effective from an accounting and budgetary basis until July 1, 2002. In this reorganization, EIP was transferred to the Division of Insurance and Grants Services.

**Contact Information:**

Questions related to the Management Discussion & Analysis and the accompanying financial statements should be directed to Phyllis Buie, Chief Financial Officer, at 734-0326.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAMS

STATEMENT OF NET ASSETS

JUNE 30, 2002

	<u>Governmental Activities</u>
<b>Assets</b>	
Current assets:	
Cash and cash equivalents	\$ 50,491,092
Premiums receivable	409,392
Prescription Drug Rebate receivable	1,120,688
Accrued interest	429,323
Due from South Carolina Division of Retirement	21,177,925
Total current assets	<u>73,628,420</u>
Non-current assets:	
Investments	21,209,979
Equipment, net of accumulated depreciation	62,375
Total non-current assets	<u>21,272,354</u>
Total assets	<u>94,900,774</u>
<b>Liabilities</b>	
Current liabilities:	
Accounts payable	752,077
Accrued payroll	253,539
Claims payable	56,051,204
Deferred premium revenue	2,064,946
Claims incurred but not reported	99,399,000
Accrued compensated absences	49,194
Total current liabilities	<u>158,569,960</u>
Long-term liabilities:	
Contingencies (Note 14)	-
Accrued compensated absences	282,930
Total long-term liabilities	<u>282,930</u>
Total liabilities	<u>158,852,890</u>
<b>Net assets</b>	
Restricted:	
South Carolina Seniors' Prescription Drug Program	5,662,478
Investment in capital assets	62,375
Unrestricted	<u>(69,676,969)</u>
Total net assets	<u>\$ (63,952,116)</u>

See accompanying notes.



SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAMS  
STATEMENT OF ACTIVITIES

FOR THE YEAR ENDED JUNE 30, 2002

		Program Revenue		Net (Expense) Revenue and Changes in Net Assets
	Expenses	Operating Contributions	Charges for Services	Governmental Activities
<b>Activities:</b>				
Senior drug program	\$ 21,346,335	\$ 17,305,299	\$ -	\$ (4,041,036)
Health	923,326,280	-	964,813,826	41,487,546
Dental	53,762,401	-	46,563,035	(7,199,366)
Life and disability	38,758,551	-	40,727,203	1,968,652
Administration	37,318,760	-	551,338	(36,767,422)
Total governmental activities	<u>\$ 1,074,512,327</u>	<u>\$ 17,305,299</u>	<u>\$ 1,052,655,402</u>	<u>(4,551,626)</u>
General revenue and transfers:				
Appropriations				100,000
Earnings on investments				11,158,948
Miscellaneous				225,748
Transfers to other agencies				(847,245)
Total general revenue and transfers				<u>10,637,451</u>
Change in net assets				6,085,825
Net assets at beginning of year, as restated ( <i>Note 18</i> )				<u>(70,037,941)</u>
Net assets at end of year				<u>\$ (63,952,116)</u>

*See accompanying notes.*

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAMS

BALANCE SHEET

GOVERNMENTAL FUND

YEAR ENDED JUNE 30, 2002

	<u>Senior Drug Program</u>
<b>Assets</b>	
Current assets:	
Cash and cash equivalents	\$ 6,043,480
Total current assets	<u>\$ 6,043,480</u>
<b>Liabilities and Fund Balance</b>	
Liabilities	
Current liabilities:	
Claims payable	\$ 381,002
Total current liabilities	<u>381,002</u>
Total liabilities	<u>381,002</u>
 Fund Balance	
Reserved for the Senior Drug Program	<u>5,662,478</u>
Total fund balance	<u>5,662,478</u>
Total liabilities and fund balance	<u>\$ 6,043,480</u>

*See accompanying notes.*

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAMS

STATEMENT OF REVENUE, EXPENDITURES,  
AND CHANGES IN FUND BALANCES

GOVERNMENTAL FUND

YEAR ENDED JUNE 30, 2002

	<b>Senior Drug Program</b>
	<hr/>
<b>Revenue:</b>	
Tobacco settlement	\$ 17,305,299
Investment earnings	6,694,701
Other	225,748
Total revenue	<hr/> 24,225,748 <hr/>
<b>Expenditures:</b>	
Administrative fees	349,781
Claims expense	20,996,554
Total expenditures	<hr/> 21,346,335 <hr/>
Excess of revenue over expenditures	<hr/> 2,879,413 <hr/>
<b>Other financing sources:</b>	
Transfers from other funds	77,113
Total other financial sources	<hr/> 77,113 <hr/>
Excess of revenue and other financing sources over expenditures and other financing uses	2,956,526
Fund balance, beginning of year	2,705,952
Fund balance, end of year	<hr/> \$ 5,662,478 <hr/>

*See accompanying notes.*

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAMS

STATEMENT OF NET ASSETS

PROPRIETARY FUND

JUNE 30, 2002

**Assets**

Current assets:

Cash and cash equivalents	\$ 44,447,612
Premiums receivable	409,392
Prescription Drug Rebate receivable	1,120,688
Accrued interest	429,323
Due from South Carolina Division of Retirement	21,177,925
Total current assets	<u>67,584,940</u>

Non-current assets:

Investments	21,209,979
Furniture and equipment, net of accumulated depreciation	62,375
Total non-current assets	<u>21,272,354</u>
Total assets	<u>88,857,294</u>

**Liabilities**

Current liabilities:

Accounts payable	752,077
Accrued payroll	253,539
Claims payable	55,670,202
Deferred premium revenue	2,064,946
Claims incurred but not reported	99,399,000
Accrued compensated absences	49,194
Total current liabilities	<u>158,188,958</u>

Long term liabilities:

Contingencies (Note 14)	-
Accrued compensated absences	282,930
Total long term liabilities	<u>282,930</u>
Total liabilities	<u>158,471,888</u>

**Net assets**

Investment in capital assets	62,375
Unrestricted	<u>(69,676,969)</u>
Total net assets	<u>\$ (69,614,594)</u>

*See accompanying notes.*

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAMS

STATEMENT OF REVENUE, EXPENSES,  
AND CHANGES IN NET ASSETS

PROPRIETARY FUND

YEAR ENDED JUNE 30, 2002

**Operating Revenue:**

Insurance premiums:	
Active employees:	
Health	\$ 722,884,611
Dental	43,563,243
Life	822,007
Long-term disability	12,030,670
Dependent/optional life	27,874,526
HMO-point of service	24,397,854
Retirees:	
Health	47,010,148
Dental	2,999,792
Retiree surcharge	161,637,985
HMO-point of service	168,635
Other premium revenues	1,012,068
Prescription drug rebates	7,702,525
Other	551,338
Total operating revenue	<u>1,052,655,402</u>

**Operating Expenses:**

Premiums	99,118,628
Claims:	
Health	652,498,595
Dental	47,392,940
Life	1,240,709
Long-term disability	7,023,722
HMO-point of service	2,586,104
Prescription Drug	205,986,533
Salaries and benefits	4,075,160
Professional services	30,606,944

(CONTINUED)

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAMS

STATEMENT OF REVENUE, EXPENSES,  
AND CHANGES IN NET ASSETS

PROPRIETARY FUND

(CONTINUED)

Telephone and utilities	77,979
Supplies	872,783
Other services	1,142,706
Printing and publication	303,443
Postage and shipping	213,247
Depreciation	26,499
Total operating expenses	<u>1,053,165,992</u>
Operating (loss)	(510,590)
Non-operating revenue:	
Income from deposits and investments	4,464,247
State appropriations-adoption assistance	<u>100,000</u>
Income before transfers	4,053,657
Interfund-transfers	(77,113)
Transfers to other state agencies	<u>(847,245)</u>
Change in net assets	3,129,299
Net assets, beginning of year, as restated ( <i>Note 18</i> )	<u>(72,743,893)</u>
Net assets, end of year	<u><u>\$ (69,614,594)</u></u>

*See accompanying notes.*

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAMS

STATEMENT OF CASH FLOWS

PROPRIETARY FUND

YEAR ENDED JUNE 30, 2002

**Cash Flows from Operating Activities**

Insurance premiums from customers	\$ 1,044,730,854
Other receipts	9,346,818
Payments to employees	(3,276,434)
Payments to suppliers	(1,035,313,347)
Net cash provided by operating activities	<u>15,487,891</u>

**Cash Flows from Capital and Related Financing Activities**

Purchase of fixed assets	(39,403)
Proceeds from sale of fixed assets	21,654
Net cash used in capital and related financing activities	<u>(17,749)</u>

**Cash Flows from Noncapital Financing Activities**

State appropriations-adoption assistance	100,000
Transfers to other funds	(77,113)
Transfers to other state agencies	(700,000)
Net cash used in noncapital financing activities	<u>(677,113)</u>

**Cash Flows from Investing Activities:**

Purchases of investments	(4,069,799)
Proceeds from sales and maturity of investments	1,565,333
Interest received-deposits and investments	4,461,952
Net cash provided by investing activities	<u>1,957,486</u>

Net increase in cash and cash equivalents	16,750,515
Cash and cash equivalents, beginning of year	<u>27,697,097</u>
Cash and cash equivalents, end of year	<u><u>\$ 44,447,612</u></u>

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAMS

STATEMENT OF CASH FLOWS

PROPRIETARY FUND

(CONTINUED)

<b>Reconciliation of loss to net cash provided by operating activities</b>	
Operating loss	\$ (510,590)
Adjustments to reconcile operating loss to net cash provided by operating activities:	
operating activities:	
Depreciation expense	26,499
Change in assets-(increase) decrease:	
Premiums receivable	(921,531)
Due from South Carolina Division of Retirement	(233,162)
Prescription drug rebate receivable	1,091,225
Other assets	1,731
Change in liabilities-increase (decrease):	
Accounts payable, accrued payroll and compensated absences	509,814
Deferred premium revenue	1,484,007
Claims payable and incurred but not reported	14,039,898
Net cash provided by operating activities	<u>\$ 15,487,891</u>
<b>Supplemental Information</b>	
Transfer of fixed assets	<u>\$ 147,245</u>
Unrealized gains on investments	<u>\$ 297,611</u>
Increase in investments for amortization/accretion	<u>\$ 68,670</u>

*See accompanying notes.*



SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2002

**1. Basis of Presentation and Summary of Significant Accounting Policies**

The financial statements of all funds of the South Carolina State Budget and Control Board, Employee Insurance Programs (the "Fund") were prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) as applied to governmental entities. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The more significant of the Fund's accounting policies are described below.

Reporting Entity

The core of the financial reporting entity is the primary government which has a separately elected governing body. As required by accounting principles generally accepted in the United States of America, the financial reporting entity includes both the primary government and all of its component units. Component units are legally separate organizations for which the elected officials of the primary government are financially accountable. In turn component units may have component units.

An organization other than a primary government may serve as a nucleus for a reporting entity when it issues separate financial statements. That organization is identified herein as a primary entity.

The primary government or entity is financially accountable if it appoints a voting majority of the organization's governing body including situations in which the voting majority consists of the primary entity's officials serving as required by law (e.g., employees who serve in an ex officio capacity on the component unit's board are considered appointments by the primary entity) and (1) it is able to impose its will on that organization or (2) there is a potential for the organization to provide specific financial benefits to, or impose specific financial burdens on, the primary entity. The primary entity also may be financially accountable if an organization is fiscally dependent on it even if it does not appoint a voting majority of the board. An organization is fiscally dependent on the primary entity that holds one or more of the following powers:

- (1) Determine its budget without another government's having the authority to approve and modify that budget.
- (2) Levy taxes or set rates or charges without approval by another government.
- (3) Issue bond debt without approval by another government.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**1. Basis of Presentation and Summary of Significant Accounting Policies (Continued)**

Reporting Entity (Continued)

Based on these criteria, the Fund has determined that it has no component units. This financial reporting entity includes only the Fund, a primary entity.

The South Carolina State Budget and Control Board, Employee Insurance Programs, Employee Insurance Program Fund and Seniors' Prescription Drug Program are funds of the South Carolina State Budget and Control Board, which is a part of the State of South Carolina primary government. All funds of the Employee Insurance Program, which includes the Employee Insurance Program Fund and the Seniors' Prescription Drug Program Fund, are included in this report and no other offices or funds of the South Carolina State Budget and Control Board or any other part of the State of South Carolina primary government are included. Effective July 1, 2001, the Employee Insurance Programs are under control of the Employee Benefits Division of the South Carolina Retirement System of the South Carolina State Budget and Control Board (the Board). All of the divisions of the Board reporting entity are under the control of the Executive Director of the State Budget and Control Board. The Board is composed of the Governor; the State Treasurer; the Comptroller General; the Chairman of the Senate Finance Committee; and the Chairman of the House Ways and Means Committee; all of whom serve in an ex-officio capacity.

The South Carolina State Budget and Control Board, formerly the Budget Commission, was established and created by Reorganization Plan No. 2 adopted by the General Assembly in 1950 pursuant to the terms and provisions of Act 621, Acts of 1948. Under the Act, ten state agencies were abolished as separate entities and their functions and duties were brought under the supervision of the Budget and Control Board. The funds of the Budget and Control Board are included in the Comprehensive Annual Financial Report of the State of South Carolina.

The Fund operates as a unit under the Budget and Control Board and its Executive Director. The laws of the State and the policies and procedures specified by the State for State agencies are applicable to the Fund's activities. The accompanying financial statements present the financial position and results of operations solely of the Fund and do not include any other agencies or any component units of the State of South Carolina.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**1. Basis of Presentation and Summary of Significant Accounting Policies (Continued)**

The group health, dental, life, accidental death and dismemberment and disability programs managed by the Fund are authorized in Sections 1-11-710 and 1-11-720 of the South Carolina Code of Laws of 1976, as amended. The long-term care program managed by the Fund is authorized in Section 1-11-740 of the South Carolina Code of Laws of 1976, as amended.

The Employee Insurance Program provides health insurance to eligible employees and retirees of State agencies and school districts who elect coverage through either a health maintenance organization or through the State's self-insured health plan. In addition, effective January 1, 1999, the Fund began offering a managed care pilot program limited to Medical University of South Carolina's (MUSC) employees living in Charleston, Dorchester or Berkeley counties. The "MUSC managed care program" is a self-insured HMO point of service plan. Premiums are paid through payroll deductions. The State Life is a fully insured group life plan available to all eligible active employees enrolled in the State health plan. The Long-Term Disability Plan is a self insured long-term disability plan available to eligible active state and public school employees enrolled in a State health plan. The basic dental coverage is through the State's self-insured plan which is available to eligible State and public school employees and retirees. Additional supplemental plans are available as the Supplemental Disability and the Dental Plus plans which are fully insured plans available to all eligible employees and retirees. Health and dental premiums are paid from State funds and through payroll deductions for eligible State and public school employees. Premiums for participating retirees are paid by the Agencies and the School Districts through the retirement system (employer share) and directly from the employee (employee share). State agencies and the local school districts pay the premiums for the following insured plans which are available to eligible full-time employees enrolled in a State health plan: (1) basic group life, and (2) basic long-term disability plan. The dependent/optional life program is available to eligible State and public school employees. Premiums for the dependent/optional life program are paid through payroll deduction. Premiums and the retiree surcharge (see *Note 6*) for the self-insured health and dental plans are actuarially determined and approved by the South Carolina State Budget and Control Board. Long-term care insurance is also available to eligible State and public school employees. Premiums for long-term care insurance are paid through payroll deductions. The long-term care plan is fully insured. Details on eligibility requirements and coverage for all plans are contained in the *Insurance Benefits Guide*. Premium rates for all plans are reviewed on a calendar year basis annually and adjusted as considered necessary after actuarial calculation. Interest income is considered in the premium rate setting process.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**1. Basis of Presentation and Summary of Significant Accounting Policies (Continued)**

The State as the predominant participant retains the risk of loss for the self-insured health, dental, basic life and basic long-term disability coverages.

The South Carolina Seniors' Prescription Drug Program is authorized in Section 44-130-30 and 44-130-40 of the South Carolina Code of Laws of 1976, as amended.

Beginning January 1, 2001, the South Carolina Seniors' Prescription Drug Program (the "Program") was created by the South Carolina Seniors' Prescription Drug Program Act passed by the General Assembly.

This program is administered by the State Budget and Control Board through its Employee Insurance Programs. The purpose of the program is to provide financial assistance for purchasing prescription drugs to senior citizens who are ineligible for or do not have insurance coverage or other assistance through federal, state, or private programs for these purchases. To be eligible to participate in this program a person must:

- (1) be a South Carolina resident who has attained the age of sixty-five years;
- (2) have resided in South Carolina at least six consecutive months before participation in the program;
- (3) be ineligible for Medicaid prescription benefits;
- (4) not have any pharmacy benefits or coverage from any governmental or private insurance program providing such benefits;
- (5) have an annual income that does not exceed one hundred seventy-five percent of the federal poverty level. Priority must be given to applicants without Medicare supplements or other third party benefits or coverage during the six months before application.

The program is funded from proceeds received by the State in the settlement agreement and related documents, between the State and leading United States tobacco manufacturers dated November 23, 1998.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**1. Basis of Presentation and Summary of Significant Accounting Policies (Continued)**

Basis of Presentation

The financial statements present all funds of the South Carolina State Budget and Control Board, Employee Insurance Programs:

*Government-wide Statements:* The statement of net assets and the statement of activities display information about the reporting entity. These statements include the financial activities of the overall government, except for fiduciary activities. Eliminations have been made to minimize the double-counting of internal activities. These statements distinguish between the *governmental and business-type activities* of the Fund. Governmental activities generally are financed through appropriations, taxes, intergovernmental revenues, and other nonexchange transactions. Business-type activities are financed in whole or in part by fees charged to external parties.

The statement of activities presents a comparison between direct expenses and program revenue for the different business-type activities and for each function of the governmental activities. Direct expenses are those that are specifically associated with a program or function and, therefore, are clearly identifiable to a particular function. Indirect expense allocations that have been made in the funds have been reversed for the statement of activities. Program revenue include (a) fees, fines, and charges paid by the recipients of goods or services offered by the programs and (b) grants and contributions that are restricted to meeting the operational or capital requirements of a particular program. Revenues that are not classified as program revenues, including all taxes, are presented as general revenues.

*Fund Financial Statements:* The fund financial statements provide information about the accounting funds. Separate statements for each fund category—*governmental and proprietary*—are presented. The emphasis of fund financial statements is on major governmental and enterprise funds, each displayed in a separate column. All remaining governmental and enterprise funds are aggregated and reported as nonmajor funds. The Fund has no nonmajor funds.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**1. Basis of Presentation and Summary of Significant Accounting Policies (Continued)**

Measurement Focus and Basis of Accounting

*Government-wide and Proprietary Fund Financial Statements.* The government-wide and proprietary fund financial statements are reported using the economic resources measurement focus. The government-wide and proprietary fund financial statements are reported using the accrual basis of accounting. Revenue are recorded when earned and expenses are recorded at the time liabilities are incurred, regardless of when the related cash flows take place. Nonexchange transactions, in which the Fund gives (or receives) value without directly receiving (or giving) equal value in exchange, include state appropriations, grants, entitlements, and donations. Revenue from grants, entitlements, and donations is recognized in the fiscal year in which all eligibility requirements have been satisfied. The Fund establishes claims liabilities when the information available prior to the issuance of the financial statements indicates it is probable a liability has been incurred by the date of the financial statements and the amount can be reasonably estimated.

*Government Fund Financial Statements.* Governmental funds are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Under this method, revenue is recognized when measurable and available. The Fund considers all revenue reported in the governmental funds to be available if the revenue are collected within one year after year-end. Property taxes, sales taxes, franchise taxes, licenses, and interest are considered to be susceptible to accrual. Expenditures are recorded when the related fund liability is incurred, except for claims and judgments, and compensated absences, which are recognized as expenditures to the extent they have matured. General capital asset acquisitions are reported as expenditures in governmental funds. Proceeds of general long-term debt and acquisitions under capital leases are reported as other financing sources.

Under the terms of grant agreements, certain programs are funded by a combination of specific cost-reimbursement grants, and general revenues. Thus, when program expenses are incurred, there are both restricted and unrestricted net assets available to finance the program. It is the Fund's policy to first apply restricted resources to such programs, followed by unrestricted resources.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**1. Basis of Presentation and Summary of Significant Accounting Policies (Continued)**

The Governmental Accounting Standards Board (GASB) is the recognized standard-setting body for accounting principles generally accepted in the United States of America for all State governmental entities. The accounting policies of the Fund conform to accounting principles generally accepted in the United States of America applicable to governmental and proprietary activities as prescribed by GASB. Accordingly, the Fund applies all applicable GASB pronouncements and its predecessors those applicable standards issued by the Financial Accounting Standards Board on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements.

Cash and Cash Equivalents

For purposes of the statement of cash flows, the Fund considers all highly liquid securities with a maturity of three months or less at the time of purchase to be cash equivalents. Most State agencies participate in the internal cash management pool; however, some agency accounts are not included in the pool because of restrictions on the use of funds. Because the State's internal cash management pool operates as a demand deposit account, amounts invested in the pool are classified as cash and cash equivalents. The State Treasurer administers the cash management pool. The pool includes some long-term investments such as obligations of the United States and certain agencies of the United States, obligations of the State of South Carolina and certain of its political subdivisions, certificates of deposit, collateralized repurchase agreements, and certain corporate bonds. For credit risk information pertaining to the internal cash management pool, see the deposits disclosures in *Note 4*.

The State's internal cash management pool consists of a general deposit account and several special deposit accounts. The State records each fund's equity interest in the general deposit account; however, all earnings on that account are credited to the General Fund of the State. Deposits in the general deposit account are recorded and reported at cost. However, the Fund reports its deposits in the special deposit accounts at fair value. Investments in the pool are recorded and reported at fair value. Interest earned by the agency's special deposit accounts is posted to the agency's account at the end of each month and is retained by the agency. Interest earnings are allocated based on the percentage of an agency's accumulated daily interest receivable to the total income receivable of the pool.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**1. Basis of Presentation and Summary of Significant Accounting Policies (Continued)**

The amounts shown in the financial statements as “cash and cash equivalents” represent cash on deposit with the State Treasurer as a part of the State’s internal cash management pool, and cash invested in various short-term instruments by the State Treasurer and held in separate agency accounts.

Investments

Investments, in accordance with Governmental Accounting Standards Board (GASB) Statement Number 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, are reported at fair value. Securities traded on a national exchange are valued at the last reported sales price.

Investment income consists of interest earned during the year, amortization of premiums and accretion of discounts, realized gains/losses on securities, and unrealized gains and losses resulting from changes in fair value. Earnings are posted to the agency’s account at the end of each month. Securities and securities transactions are reflected in the financial statements on a trade-date basis.

Premium Revenue

Premiums billed to employers, employees and retirees (premiums receivable) for insurance coverage are recorded as revenue when earned on a monthly basis. The retiree surcharge on employees is recognized as the liability is incurred by the various State agencies and school districts.

Deferred Premium Revenue

Premiums billed in advance of coverage, payments received in advance of coverage, or in excess of amounts billed and premiums collected but unearned are recorded as deferred premium revenue.



SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**1. Basis of Presentation and Summary of Significant Accounting Policies (Continued)**

Capital Assets

Capital assets are capitalized at cost if purchased. Capital assets contributed by other State agencies or funds are recorded at the State's original acquisition cost less accumulated depreciation from the purchase date. Assets donated by other parties are valued at fair market value at the date of gift. The capitalization dollar threshold limit for capital assets is \$5,000. The Fund has one class of capital assets, equipment, which is depreciated on a straight-line basis over the estimated useful lives of 2-10 years. A full year of depreciation is taken the year the asset is placed in service and no depreciation is taken in the year of disposal.

Claims Liabilities Including Claims Incurred but not Reported (IBNR)

Losses are recorded at estimated amounts at the time they are reported and include a provision for expenses associated with claim settlements. Insurance claims are expensed as incurred over the period of coverage. The Fund establishes an unpaid claim liability for claims in the process of review, and for IBNR claims. The liability for IBNR claims is actuarially estimated based on the most current historical claims experience of previous payments, changes in number of members and participants, inflation, award trends, and estimates of health care trend (cost, utilization and intensity of services) changes. Estimates of liabilities for incurred claims are continually reviewed and revised as changes in these factors occur and revisions are reflected in the current year's operating statement in the applicable claims expense. Amounts for allocated and unallocated claims adjustment expenses have been included in the calculation of IBNR.

Claim costs for long-term disability coverages are actuarially calculated using the one-year term cost method; the cost of coverage is the present value of all benefit payments that will be made on expected claims incurred during the year following the valuation date. Claim liabilities are equal to the present value, as of the valuation date, of all future payments to be made for disabilities and deaths up to that date. Actuarial assumptions include an interest rate of 7.25% for 2002 compounded annually.

Claims Payable

Claims payable represents claims related to health claims, dental claims, and Long-Term Disability claims payable at June 30. The claims payable balance is based on claims that have been paid by the third party administrators on behalf of the Fund.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**1. Basis of Presentation and Summary of Significant Accounting Policies (Continued)**

Compensated Absences

Generally all permanent full-time State employees and certain part-time employees scheduled to work at least one-half of the agency's workweek are entitled to accrue and carry forward at calendar year-end maximums of 180 days sick leave and of 45 days annual vacation leave. Upon termination of State employment, employees are entitled to be paid for accumulated unused annual vacation leave up to the maximum, but are not entitled to any payment for unused sick leave. The compensated absences liability includes accrued annual leave earned for which the employees are entitled to paid time off or payment at termination. The leave liability also includes an estimate for unused sick leave and leave from the agency's leave transfer pool for employees who have been approved as leave recipients under personal emergency circumstances. The Fund calculates the gross compensated absences liability based on recorded balances of unused leave. The entire unpaid liability for which the employer expects to compensate employees through paid time off or cash payments, inventoried at fiscal year-end current salary costs and the cost of the salary-related benefit payments, is recorded in the Fund.

Net Assets

Net assets are recorded in three categories:

Investment in capital assets, net of related debt consists of capital assets net of accumulated depreciation and reduced by outstanding balances for bonds, notes, and other debt that are attributed to the acquisition, construction or improvement of those assets.

Restricted net assets result when constraints placed on net asset use are either imposed by creditors, grantors, contributors, and the like or imposed by law through constitutional provisions or enabling legislation.

Unrestricted net assets consist of net assets which do not meet the definition of restricted net assets or investment in capital assets, net of related debt.

The Fund applies expenses that can use both restricted and unrestricted resources against restricted resources then unrestricted resources.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**1. Basis of Presentation and Summary of Significant Accounting Policies (Continued)**

Budget Policy

The General Assembly enacts a budget for the Fund within the Division of the South Carolina Retirement System budgetary unit of the State Budget and Control. The Appropriation Act authorizes expenditures from funds appropriated from the General Fund of the State and authorizes expenditures of total funds. The Budgetary column includes all budgeted resources, including the State General Fund as well as most federal fund and department-generated sources. A revenue budget is not adopted for individual budgetary units.

The accompanying other financial information include a Statement of Expenditures-Budget and Actual-All Budgeted Funds. The Budgetary column on that statement corresponds to the difference between Total Funds and General Funds columns in the Appropriations Act.

The current Appropriations Act states that the General Assembly intends to appropriate all monies to operate state government for the current fiscal year. Any unexpended state General Fund appropriations lapse to the General Fund of the State on July 31 unless specific authorization is given to carryover the funds to the ensuing fiscal year. Appropriations carried forward for a specific purpose are reported as restricted net assets. Proviso 63.18 of the 2002/2003 Appropriations Act authorizes the South Carolina Seniors' Prescription Drug Program to carry forward unspent State General Fund appropriations.

During the fiscal year close-out period through July, departments and agencies may continue to charge vendor, interagency, and interfund payments applicable to the current year to this fiscal year's appropriation.

State law does not precisely define the budgetary process of accounting. The budget is prepared mostly on the cash basis with several exceptions. Departments and agencies charge certain vendor and interfund payments against the preceding fiscal year's appropriations through July 20. State law does not require the use of encumbrance accounting. Because the legally prescribed budgetary basis differs materially from GAAP, actual amounts in the accompanying budgetary comparison statements are presented on the budgetary basis. A reconciliation of the differences between the budgetary basis is presented in *Note 2*.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**1. Basis of Presentation and Summary of Significant Accounting Policies (Continued)**

The state maintains budgetary control at the line-item level of expenditure within each program of each department or agency. All general fund expenditures are budgeted. The Fund processes its disbursement vouchers through a central budgetary accounting system maintained by the Comptroller General's Office. Disbursement vouchers can only be processed if there is enough cash and appropriations exist. The level of legal control is reported in a publication of the State Comptroller General's Office titled *A Detailed Report of Appropriations and Expenditures*.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

Effects of Accounting and Reporting Changes

As a result of the adoption of GASB Statement No. 34, the Fund was required to make certain changes in accounting principles resulting in the restatement of beginning net assets. The changes required are discussed in detail in *Note 18*.

Classification of Revenue

The Fund has established the following criteria for reporting operating revenue or nonoperating revenue:

Operating revenue generally results from exchange transactions to provide the services authorized by State Statute. These revenue include (1) premiums for insurance coverage, (2) administrative fees, and (3) other receipts arising from services provided.

Nonoperating revenue include activities that have the characteristics of nonexchange transactions. These revenue include appropriations, investment income, and contract revenue not classified as operating revenue or restricted by the provider to be used exclusively for capital purposes.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**2. Budgetary Reporting Basis**

Financial statements prepared on the legally enacted basis differ from GAAP basis statements. All of the Fund's Special Revenue Fund resources are included in the total funds authorized by the General Assembly. The Statement of Expenditures-Budget and Actual-All Budgeted Funds presented on page 57 present all funds for which a legal budget was enacted.

Adjustments of the GAAP basis of accounting to the budgetary basis of accounting consist principally of reclassifications from financial statement fund types to budgetary fund categories, reversals of payroll accruals and the related fringe benefits, and removals of unbudgeted accounts and funds, if any. Acquisitions of fixed assets by donation are unbudgeted and capital lease and installment purchase transactions are budgeted in the year of payment.

The following schedule reconciles the differences:

	<b>Financial Statement Fund Type Special Revenue</b>	<b>Adjustment</b>	<b>Budgetary Category</b>
Administrative fees	\$ 349,781	\$ (349,781)	\$ -
Claims expense	20,995,554	(20,995,554)	-
Other budgeted expenses	-	21,345,335	21,345,335
Total expenditures	<u>\$ 21,345,335</u>	<u>\$ -</u>	<u>\$ 21,345,335</u>

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**3. Other Budgeted Funds**

The 2001-2002 original appropriations are the base budget amounts for the South Carolina Seniors' Prescription Drug Program budgetary units and are presented in the Total Funds column of Section 63B.IV.D of the Appropriations Act.

Proviso 63.18 of the 2002/2003 General Appropriations Act cites the authority for the Fund to carry forward unspent appropriations from fiscal year 2002 to expenditure in fiscal year 2003. The restricted purposes are noted in the captions for the referenced amounts on page 3.

Annual fiscal year 2001 appropriations of \$2,705,952 for Seniors' Prescription Drug Program, were approved for carry forward to fiscal year 2002 for expenditure for the same purpose.

Annual fiscal year 2002 appropriations of \$5,663,478 were approved for carryforward to the fiscal year 2003 for expenditure for the same purpose.

**4. Investments and Deposits**

As prescribed by Statute, the State Treasurer is the custodian and investment manager of all investments and deposits of the Fund.

Investments

In accordance with State Law, the Fund may invest in a variety of instruments including obligations of the United States and its agencies and securities fully guaranteed by the United States, certain corporate obligations, certain shares of Federal savings and loan associations and State chartered savings and loan associations, and collateralized repurchase agreements. All investments are required to be insured or registered, or held by the State or its agent in the name of the State Treasurer as custodian.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**4. Investments and Deposits (Continued)**

The Fund's investments are categorized to give an indication of the level of risk assumed by the entity at year-end. The credit risk categories are concerned with custodial credit risk, which is the risk that a government will not be able to recover the value of investment or collateral securities that are in the possession of an outside party if the counterparty to the investment transaction fails. There are three categories of credit risk.

- (1) Insured or registered in the agency's name, or securities held by the agency or its agent in the agency's name.
- (2) Uninsured and unregistered, with securities held by the counterparty's trust department or agent in the agency's name.
- (3) Uninsured and unregistered, with securities held by the counterparty, or by its trust department or agent but not in the agency's name.

At June 30, 2002, all of the Fund's long-term investments were in Category (1).

With respect to investments in the State's internal cash management pool, all of the State Treasurer's investments are insured or registered or are investments for which the securities are held by the State or its agents in the State's name. Information pertaining to the reported amounts, fair values, and credit risk of the State Treasurer's investments is disclosed in the Comprehensive Annual Financial Report of the State of South Carolina.

The following table presents the amortized cost and fair values of the investments of the Fund at June 30, 2002.

	Amortized Cost	Unrealized		Fair Value
		Gains	Losses	
U. S. Government agencies securities	\$ 500,000	\$ -	\$ -	\$ 500,000
Collateralized mortgage-backed obligations	4,651,599	248,834	-	4,900,433
Repurchase agreement	7,870,000	-	-	7,870,000
Corporate bonds	12,541,263	515,057	(650,070)	12,406,250
Financial paper	3,244,095	159,201	-	3,403,296
Total	<u>\$ 28,806,957</u>	<u>\$ 923,092</u>	<u>\$ (650,070)</u>	<u>\$ 29,079,979</u>

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**4. Investments and Deposits (Continued)**

At June 30, 2002, the amortized cost of the above investments was comprised of the following:

	Par Value	Unamortized Premiums	Unaccrued Discounts	Amortized Cost
U. S. Government agencies	\$ 500,000	\$ -	\$ -	\$ 500,000
Collateralized mortgage-backed obligations	4,804,503	-	(152,904)	4,651,599
Repurchase agreement	7,870,000	-	-	7,870,000
Corporate bonds	12,790,000	123,965	(372,702)	12,541,263
Financial paper	3,300,000	-	(55,905)	3,244,095
	<u>\$ 29,264,503</u>	<u>\$ 123,965</u>	<u>\$ (581,511)</u>	<u>\$ 28,806,957</u>

The accounts classified as investments in the financial statements comprise investments held for the Fund and the State of South Carolina which are legally restricted and earnings thereon become revenue of the specific fund from which the investment was made. These investments are specific, identifiable investment securities, some of which may be included in one of the State Treasurer's investment pools.

The investment types listed above include all investment types in which monies were held as long-term investments throughout the fiscal year. For all investment classifications reported above, the balances therein fluctuated minimally in excess of the year-end balances throughout the year ended June 30, 2002. As discussed in *Note 1*, GASB Statement Number 31 required investments reported at fair value. Therefore, gains and losses recognized due to market fluctuations are recognized as income on deposits and investments. The Fund held no short-term investments at June 30, 2002. Short-term investments held during the fiscal year 2002 consisted of U.S. Government agency and government-insured securities whose amortized cost approximates fair value at June 30, 2002.



SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**4. Investments and Deposits (Continued)**

The investment types listed above include all investment types in which monies were held throughout the year ended June 30, 2002. Due to higher cash flows at certain times during the year, the Fund's investment in repurchase agreements and short-term investments fluctuated significantly. The maximum amounts held in these classifications during the year ended June 30, 2002, were as follows:

Short-term investments	\$ 493,246
Repurchase agreements	<u>\$ 23,858,000</u>

Deposits

All deposits with financial institutions are required to be insured or collateralized with securities held by the State or its agent in the State Treasurer's name as custodian. At June 30, 2002, the Fund had no deposits with financial institutions. The Fund had cash and pooled investments of \$826 and \$42,620,266, respectively, held by the State Treasurer as of June 30, 2002.

Fair market value for cash and cash equivalents reported approximate the carrying value.

During the year, the following amounts (which apply to all investments) were included in investment earnings:

	<u><b>2002</b></u>
Interest earned	\$ 10,762,636
Discount accretion	76,811
Premium amortization	(8,141)
Realized gains (losses)	30,031
Change in unrealized gains (losses)	<u>297,611</u>
Investment earnings	<u><u>\$ 11,158,948</u></u>

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**4. Investments and Deposits (Continued)**

The following schedule reconciles investments and deposits as reported in the statement of net assets to disclosures included in this note.

	<u>Statements</u>	<u>Note Disclosure</u>
Held by the State Treasurer:		
Cash and cash equivalents	\$ 50,491,092	\$ 826
Pooled investments	-	42,620,266
Specifically identified investments	21,209,979	29,079,979
Total	<u>\$ 71,701,071</u>	<u>\$ 71,701,071</u>

**5. Premiums Receivable**

Premiums receivable at June 30, 2002, consist of the following:

Local government	\$ 168,470
State government ( <i>Note 13</i> )	222,613
Other	18,309
	<u>\$ 409,392</u>

As of June 30, 2002, all of the receivables are deemed by management to be collectible. Therefore, no allowance for doubtful accounts has been recognized. In addition, the Fund has applied no discounts to its receivables as of June 30, 2002.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**6. Due from South Carolina Division of Retirement**

At June 30, 2002, a total of \$21,177,925 consisting of \$20,796,111 from South Carolina Retirement System and \$431,814 from Police Officers Retirement System were due from the South Carolina Retirement Systems. In accordance with provisions of the Appropriations Act for each year, an additional employer contribution surcharge on covered payroll was added to the contribution rate applicable to entities covered by the State Health Insurance Plan. Accordingly, these amounts represent revenues collected on behalf of the Fund of a percentage of covered compensation from all State agencies and public school systems to be used for health and dental insurance benefits of State retirees. The percentage in effect was 2.85% from July 1, 2001 to June 30, 2002.

**7. Capital Assets**

The following are summaries of changes in capital assets for the year.

	<b>Balance as restated July 1, 2001</b>	<b>Additions</b>	<b>Deletions</b>	<b>Balance June 30, 2002</b>
Furniture and equipment	\$ 714,980	\$ 39,402	\$ (531,864)	\$ 222,518
Accumulated depreciation	(496,611)	(26,499)	362,967	(160,143)
Capital assets, net	<u>\$ 218,369</u>	<u>\$ 12,903</u>	<u>\$ (168,897)</u>	<u>\$ 62,375</u>

Depreciation expense for the year ended June 30, 2002 was \$26,499. Included in deletions above are transfers of equipment to the Insurance Reserve Fund of \$147,245.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**8. Lease Obligations**

The Fund leases office space from a party outside of State government and is accounted for as an operating lease. The office space lease was amended effective July 1, 2002, and now expires June 1, 2005. Rental expense under this lease for the year ended June 30, 2002 was \$369,930.

The following schedule summarizes the Fund's obligations under operating leases having remaining terms in excess of one year as of June 30, 2002:

<b><u>Fiscal Year</u></b> <b><u>Ending June 30,</u></b>	<b><u>Total</u></b>
2003	\$ 327,264
2004	327,264
2005	<u>327,264</u>
Total	<u><u>\$ 981,792</u></u>

The Fund has also entered into an operating lease from a party outside of State government which will expire in 2006 for office equipment which contains a cancellation provision and is subject to annual appropriation. In the normal course of business, operating leases are generally renewed or replaced by other leases. Operating leases are generally payable on a monthly basis. For the year ended June 30, 2002, expenses under these leases were approximately \$17,543.

**9. Restricted Net Assets**

South Carolina Seniors' Prescription Drug Program (the "Program") at June 30, 2002, had \$5,662,478 in net assets. These funds are restricted for claims and administrative expenditures of the Program.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**10. Pension Plans**

The Retirement Division maintains four independent defined benefit plans and issues its own publicly available Comprehensive Annual Financial Report (CAFR) which includes financial statements and required supplementary information. A copy of the separately issued CAFR may be obtained by writing to the South Carolina Retirement Division, Post Fund Box 11960, Columbia, South Carolina 29211-1960. Furthermore, the Division and the four pension plans are included in the CAFR of the State of South Carolina.

The majority of employees of the Fund are covered by a retirement plan through the South Carolina Retirement System (SCRS), a cost-sharing multiple-employer defined benefit pension plan administered by the Retirement Division of the State Budget and Control Board, a public employee retirement system. Generally all State employees are required to participate in and contribute to the SCRS as a condition of employment unless exempted by law as provided in Section 9-1-480 of the South Carolina Code of Laws. This plan provides retirement annuity benefits as well as disability, cost of living adjustment, death, and group-life insurance benefits to eligible employees and retirees.

Under the SCRS, employees are eligible for a full service retirement annuity upon reaching age 65 or completion of 28 years credited service regardless of age. The benefit formula for full benefits effective since July 1, 1989, for the SCRS is 1.82 percent of an employee's average final compensation multiplied by the number of years of credited service. Early retirement options with reduced benefits are available as early as age 55. Employees are vested for a deferred annuity after five years service and qualify for a survivor's benefit upon completion of 15 years credited service (five years effective January 1, 2001). Disability annuity benefits are payable to employees totally and permanently disabled provided they have a minimum of five years credited service (this requirement does not apply if the disability is the result of a job-related injury). A group-life insurance benefit equal to an employee's annual rate of compensation is payable upon the death of an active employee with a minimum of one year of credited service.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**10. Pension Plans (Continued)**

Effective January 1, 2001, Section 9-1-2210 of the South Carolina Code of Laws allows employees eligible for service retirement to participate in the Teacher and Employee Retention Incentive (TERI) Program. TERI participants may retire and begin accumulating retirement benefits on a deferred basis without terminating employment for up to five years. Upon termination of employment or at the end of the TERI period, whichever is earlier, participants will begin receiving monthly service retirement benefits which will include any cost of living adjustments granted during the TERI period. Because participants are considered retired during the TERI period, they do not make SCRS contributions, do not earn service credit, and are ineligible to receive group life insurance benefits or disability retirement benefits.

Since July 1, 1988, employees participating in the SCRS have been required to contribute 6 percent of all compensation. For the year ended June 30, 2002, the employer contribution rate was 7.55 percent (before a surcharge to fund retiree health and dental insurance coverage). The Fund's actual contributions to the SCRS for those years were approximately \$280,000, respectively, and equaled the required contributions of 7.55 percent (excluding the surcharge) for each year. Also, the Fund paid employer group-life insurance contributions at the rate of .15 percent of compensation for the year ended June 30, 2002.

The amounts paid by the Fund for pension and group-life benefits are reported as employer contribution expenditures within the applicable administrative expenditure categories to which the related salaries are charged.

Article X, Section 16 of the South Carolina Constitution requires that all State-operated retirement systems be funded on a sound actuarial basis. Title 9 of the South Carolina Code of Laws of 1976, as amended, prescribes requirements relating to membership, benefit and employee/employer contributions for each retirement system. Employee and employer contribution rates to SCRS are actuarially determined. The surcharges to fund retiree health and dental insurance are not part of the actuarially established rates. Annual benefits, payable monthly for life, are based on length of service and on average final compensation (an annualized average of the employee's highest 12 consecutive quarters of compensation).

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**10. Pension Plans (Continued)**

The Systems do not make separate measurements of assets and pension benefit obligations for individual employers. Under Title 9 of the South Carolina Code of Laws, the Fund's liability under the plans is limited to the amount of contributions (stated as a percentage of covered payroll) established by the State Budget and Control Board. Therefore, the Fund's liability under the pension plans is limited to the amounts appropriated therefore in the South Carolina Appropriation Act and amounts from other applicable revenue sources. Accordingly, the Fund recognizes no contingent liability for unfunded costs associated with participation in the plans.

At retirement, employees participating in the SCRS receive additional service credit (at a rate of 20 days equals one month of services) for up to 90 days for accumulated unused sick leave.

**11. Post-Employment and Other Employee Benefits**

In accordance with the South Carolina Code of Laws and the annual Appropriation Act, the State of South Carolina provides certain health care, dental, and life insurance benefits to certain active and retired State employees and certain surviving dependents of retirees. All permanent full-time and certain permanent part-time employees of the Fund are eligible to receive these benefits. The State provides post employment health and dental benefits to employees who retire from State service or who terminated with at least 20 years of State service who meet one or more of the eligibility requirements, such as age, length of service, and hire date. Generally those who retire must have at least 10 years of retirement service credit to qualify for State-funded benefits. Benefits are effective at date of retirement when the employee is eligible for retirement benefits.

These benefits are provided through annual appropriations by the General Assembly to the Fund for its active employees and to the State Budget and Control Board for all participating State retirees except the portion funded through the pension surcharge and provided from other applicable sources of the Fund for its active employees who are not funded by State General Fund appropriations. The State finances health and dental plan benefits on a pay-as-you-go basis. Currently, approximately 20,100 State retirees meet these eligibility requirements.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**11. Post-Employment and Other Employee Benefits (Continued)**

The Fund recorded employer contributions expenditures within the applicable administrative expenditure categories for these insurance benefits for active employees of approximately \$221,000, for the year ended June 30, 2002. As discussed in *Note 13*, the Fund paid approximately \$77,000 for the year ended June 30, 2002, applicable to the surcharge included with the employer contributions for retirement benefits (2.85% for 2002).

Information regarding the cost of insurance benefits applicable to Fund retirees is not available. By State law, the Fund has no liability for retirement benefits. Accordingly, the cost of providing these benefits for retirees is not included in the accompanying financial statements.

In addition, the State General Assembly periodically directs the Retirement Systems to pay supplemental (cost of living) increases to retirees. Such increases are primarily funded from Systems' earnings; however, a portion of the required amount is appropriated from the State General Fund annually for the SCRS benefits.

**12. Deferred Compensation Plans**

Several optional deferred compensation plans are available to State employees and employers of its political subdivisions. Certain employees of the Fund have elected to participate. The multiple-employer plans, created under Internal Revenue Code Sections 457, 401 (k), and 403 (b), are administered by third parties and are not included in the Comprehensive Annual Financial Report of the State of South Carolina. Compensation deferred under the plans is placed in trust for the contributing employee. The State has no liability for losses under the plans. Employees may withdraw the current value of their contributions when they terminate State employment. Employees may also withdraw contributions prior to termination if they meet requirements specified by the applicable plan.



SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**12. Deferred Compensation Plans (Continued)**

The State authorized deferred compensation matching contributions for fiscal year 2000-2001. The contributions are funded from various funding sources based on the same percentages used for employees' salaries. The State appropriated funds from unspent fiscal year 1999-2000 appropriations for the portion of contributions paid from State General Funds to 401(k) accounts of eligible state employees. The 401(k) match is limited to \$300. To be eligible, an employee must be a permanent full-time state employee or temporary grant employee who is actively contributing to a 401(k), 457 or 403(b) account on the date of distribution. Permanent full-time employees making less than \$20,000 as of July 1, 2000, are not required to contribute in order to receive the match.

This Fund made no contributions for the fiscal year ending June 30, 2002.

**13. Transactions with State Entities**

The Fund has significant transactions with the State of South Carolina and various State agencies.

Services received at no cost include payroll processing, disbursement processing and maintenance of certain accounting records from the Comptroller General; check preparation, banking and investment functions from the State Treasurer; and legal services from the Attorney General.

The following services are provided for a fee to various State agencies and within the South Carolina State Budget and Control Board. The fees are recorded as revenues in the financial statements for the Fund. Total amounts of premiums received from other state agencies is not readily available.

Insurance coverage for state agencies and local governments:

- Health
- Dental
- Basic group-life and disability
- State Life and Long-Term Disability

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**13. Transactions with State Entities (Continued)**

A significant portion of the Fund's total insurance premium revenue is for insurance premiums charged to other state agencies and divisions of the South Carolina State Budget and Control Board. Premiums owed from these entities at June 30, 2002 were:

COBRA and Retirees of State Agencies	\$ 43,489
Adjutant General's Office	18
Attorney General	12
South Carolina Budget and Control Board	209
Commission on Higher Education	2,789
Commission on Indigent Defense	459
Department of Agriculture	2
Department of Corrections	40,708
Department of Education	531
Department of Health and Environmental Control	874
Department of Labor, Licensing and Regulation	374
Department of Mental Health	11,739
Department of Parks, Recreation and Tourism	9,046
Department of Revenue and Taxation	1,088
Department of Social Services	44,599
Department of Transportation	3
Employment Security Commission	4,944
Forestry Commission	1,007
Governor's Office	1,411
Department of Health and Human Services	171
Higher Education Tuition Grants Commission	2
Patriots Point Development Authority	1,960
Procurement Review Panel	80
Public Service Commission	4
South Carolina Administrative Law Judge Division	93
South Carolina Commission for the Blind	16
South Carolina Commission on Prosecution Coordination	288
South Carolina Department of Consumer Affairs	2,642
South Carolina Department of Alcohol and other drug abuse	523

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**13. Transactions with State Entities (Continued)**

South Carolina Department of Insurance	1,105
South Carolina Department of Juvenile Justice	1,500
South Carolina Department of Probation and Parole	3,012
South Carolina Department of Public Safety	8
South Carolina Educational Television Commission	3,048
South Carolina Human Affairs Commission	35
South Carolina Museum Commission	1,098
South Carolina State Housing Finance	233
South Carolina State Senate	3
South Carolina Worker's Compensation Commssion	29,344
Sea Grant Consortium	304
Second Injury Fund	52
South Carolina Education Lottery	682
State Accident Fund	335
State Board for Technical and Comprehensive Education	26
State Board of Financial Institutions	15
State Election Commission	2,438
State Ethics Commission	154
State Law Enforcement Division	8
State Treasurer	89
Vocational Rehabilitation	2,866
Wil Lou Gray Opportunity School	7,177
	<hr/>
	<u><u>\$ 222,613</u></u>

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**13. Transactions with State Entities (Continued)**

The following details the insurance premiums charged by the Fund to other state agencies and divisions of the South Carolina State Budget and Control Board during the year ended June 30, 2002:

Active employees:	
Health	\$ 267,187,420
Dental	16,204,411
Life	311,134
Long-term disability	4,608,624
Dependent/optional life	12,646,766
HMO-point of service	9,090,349
Retirees:	
Health	22,915,758
Dental	1,493,792
Retiree surcharge	68,186,939
HMO-point of service	94,196
	<u>\$ 402,739,389</u>

The Fund had financial transactions with various State agencies during the fiscal year. Significant payments were made to Divisions (Funds) of the State Budget and Control Board for retirement and insurance plans contributions, vehicle rental, surplus property disposal fees, Fund supplies, printing, and telephone, interagency mail, data processing services, purchasing, record maintenance, internal audit and personnel services. Significant payments were also made for unemployment and workers' compensation coverage for employees to other agencies. The amounts of 2002 expenses applicable to related party transactions are not readily available.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**13. Transactions with State Entities (Continued)**

The following services are received from other Divisions (Funds) of the South Carolina State Budget and Control Board at no charge:

Division of Operations

Record storage

Division of Retirement

Collection of health and dental premiums from retirees

Retirement plan administration

Collection of retiree insurance surcharge from employers

The Fund acted as fiduciary for premiums collected from state agencies for State Long-Term Disability. During the year ended June 30, 2002, \$2,919,509 was collected from state agencies and disbursed to the State Long-Term Disability carrier.

Additionally, refer to *Note 6* for a description of the amounts due from South Carolina Division of Retirement.

The Fund offers a managed care pilot program to MUSC's employees living in Charleston, Dorchester or Berkeley counties. Refer to *Note 1* for a complete description.

During the 2001-2002 fiscal year, the Employee Insurance Program was given an appropriation of \$100,000, issued under proviso 63.61. These funds were used to provide grants to eligible employees to assist them with the direct costs of adoption. The employees are eligible if they participate in the Employee Insurance Program and have adopted a child during the prior fiscal year, apply for the grant during the annual application period, and meet any other Adoption Program criteria. The maximum grant was \$10,000 for a special needs child and \$5,000 for all other child adoptions.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**14. Contingencies**

By the nature of its operations and responsibilities as an insurer, the Fund has been named in a number of lawsuits, many of which are pending. A provision has been made in the financial statements for the payment of routine claims. Management is not aware of any other claims that, in their opinion, would have a material effect on the financial statements and, therefore, no liability has been recorded.

**15. Risk Management/Reinsurance**

The Fund is exposed to various risks of loss and maintains State or commercial insurance coverage for each of those risks except for certain types of risks for which it is self-insured (these risks are further described herein). Management believes such coverage is sufficient to preclude any significant uninsured losses for the covered risks. There were no significant reductions in insurance coverage from coverage in the prior year. Settled claims have not exceeded this coverage in any of the past three years.

The Fund pays insurance premiums to itself and certain other State agencies and commercial insurers to cover risks that may occur in normal operations. The insurers promise to pay to or on behalf of the insured for covered economic losses sustained during the policy period in accord with insurance policy and benefit program limits.

State management believes it is more economical to manage certain risks internally and set aside assets for claim settlement. Several State funds accumulate assets and the State itself assumes substantially all risks for the following:

1. Claims of State employees for unemployment compensation benefits (Employment Security Commission);
2. Claims of covered employees for workers' compensation benefits for job-related illnesses or injuries (State Accident Fund);
3. Claims of covered public employees for health and dental insurance benefits (Employee Insurance Programs); and
4. Claims of covered public employees for long-term disability and group-life insurance benefits (Employee Insurance Programs).

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**15. Risk Management/Reinsurance (Continued)**

Employees elect health coverage through either a health maintenance organization or through the State's self-insured plan. All of the other coverages listed above are through the applicable State self-insured plan except dependent and optional life premiums are remitted to commercial carriers.

The Fund and other entities pay premiums to the Insurance Reserve Fund which issues policies, accumulates assets to cover the risks of loss, and pays claims incurred for covered losses related to the following Fund assets, activities, and/or events:

1. Theft of, damage to, or destruction of assets;
2. Auto liability for non-state owned vehicles; and
3. General torts.

State agencies and other entities are the primary participants in the Fund.

The Fund obtains coverage of up to \$750,000 per loss through a commercial carrier for employee fidelity bond insurance for all employees for losses arising from theft or misappropriation.

The Fund has recorded insurance premium expense regarding its internal operations in the applicable administrative expense categories.

The Fund has not transferred the portion of the risk of loss related to insurance policy deductibles and limits. The Fund has not reported an estimated claims loss expense, and the related liability at June 30, 2002, based on the requirements of GASB 10 because information at June 30 did not indicate that an asset had been impaired or a liability had been incurred. GASB 10 states that a liability for claims must be reported only if information prior to issuance of the financial statements indicates that it is probable that an asset has been impaired or a liability has been incurred on or before June 30 and the amount of loss is reasonably estimable.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**15. Risk Management/Reinsurance (Continued)**

The Insurance Reserve Fund purchases insurance and reinsurance and separately reports the related reinsurance premium and premium expenses. Insurance is purchased to cover risks where the Insurance Reserve Fund has limited expertise (aircraft insurance and ocean marine insurance). Reinsurance is purchased to limit the Insurance Reserve Fund's liability for catastrophic loss (property reinsurance and medical professional liability reinsurance), to obtain specialized engineering services (boiler and machinery reinsurance), or to obtain services for which the Insurance Reserve Fund is not adequately staffed (automobile liability reinsurance).

The Fund self-insures health and dental insurance for all participating governmental employees, including those of the Fund. Additionally, effective January 1, 1999, the Fund began offering a self-insured HMO point of service plan to certain employees of MUSC. The Fund purchases coverage for basic group life, dependent life, optional supplemental life, group optional life and basic disability from commercial carriers. The State Long-Term Disability program is also self-insured.

The Insurance Reserve Fund self insures Tort Liability Insurance, Automobile Physical Damage Insurance, and the self insured retention for Property, Medical Professional Liability, and Boiler and Machinery Insurance.

Reinsurance for catastrophic losses is purchased for losses above the following loss levels:

Property-\$2,000,000 per location/\$10,000,000 per occurrence

Medical malpractice-\$250,000



SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**16. Reconciliation of Claims Liabilities by Fund**

The schedule below presents the changes in claims liabilities for the past two years for the Fund.

	(in thousands)	
	2002	2001
Unpaid claims and claim adjustment expenses at beginning of the fiscal year	\$ 141,029	\$ 157,439
Incurred claims and claim adjustment expenses:		
Provision for insured events of the current fiscal year	736,051	629,985
Increases (decreases) in provision for insured events of prior fiscal years	180,677	146,672
Total incurred claims and claim adjustment expenses	916,728	776,657
Payments:		
Claims and claim adjustment expenses attributable to insured events of the current fiscal year	644,567	554,842
Claims and claim adjustment expenses attributable to insured events of prior fiscal years	258,121	238,225
Total payments	902,688	793,067
Total unpaid claims and claim adjustment expenses at end of the fiscal year	<u>\$ 155,069</u>	<u>\$ 141,029</u>
The above totals are comprised of the following:		
Claims payable	\$ 55,670	\$ 44,185
Claims incurred but not reported	99,399	96,844
Total	<u>\$ 155,069</u>	<u>\$ 141,029</u>

The HMO self-insured managed care plan liability at June 30, 2002 and 2001 was \$2,698,021 and \$1,368,267, respectively, and is included in the claims liability listed above.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**17. Changes in Long-Term Liabilities**

Changes in long-term obligations for the year ended June 30, 2002, were as follows:

	<u>Beginning Balance July 1, 2001</u>	<u>Increases</u>	<u>Decreases</u>	<u>Ending Balance June 30, 2002</u>	<u>Due Within One Year</u>
Compensated absences payable	\$ 272,903	\$ 111,341	\$ (52,120)	\$ 332,124	\$ 49,194

**18. Restatement**

In conjunction with the adoption of GASB Statement No. 34, as discussed in *Note 1*, the State of South Carolina adopted a new capitalization limit of \$5,000 for movable personal property and \$100,000 for depreciable land improvements, buildings and improvements, and intangible assets, as of July 1, 2001. As a result of the change in asset capitalization policy, the Employee Insurance Programs Fund removed capitalized assets and the related accumulated depreciation which did not meet the new capitalization levels.

The beginning net assets as of July 1, 2001, were restated for the above accounting changes, which are disclosed in the following schedule.

Net assets, July 1, 2001, as previously reported	\$ (72,263,447)
Restatement Adjustments:	
Change in capitalization levels	(637,005)
Accumulated depreciation on assets written off	156,559
Net assets July 1, 2001, as restated	<u>\$ (72,743,893)</u>

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**19. Discussion of Fund Deficit in FY 2001-2002**

During 2001/2002, the Employee Insurance Programs Fund reported an increase in net assets of \$6,085,825. This income, along with losses in recent years, has resulted in liabilities exceeding assets of \$63,952,116 for the Fund at June 30, 2002. Additionally, Section 1-11-710(A)(4) of the South Carolina Code of Laws, 1976, as amended, stipulates that “a reserve equal to not less than an average of one and one-half months’ claims must be maintained in the accounts and all funds in excess of the reserve must be used to reduce premium rates or expand benefits as funding permits.” Under Proviso 63.15 the reserve requirement was changed. The Proviso reads “Notwithstanding any other provision of law, the State Health Plan is only required to seek a zero day reserve fund by the end of calendar year 2002. Although certain changes in the funding and coverages have taken place, there is no guarantee that the Fund will return to a surplus position or that cash will be adequate to cover claims and administrative costs. Additional funding sources, such as further rate increases, State appropriations, etc. may be necessary to provide for the costs of the continued existence of the Plan. For further discussion regarding the Fund deficit, see Management’s Discussion and Analysis.

**20. Subsequent Events**

In early 2002, the South Carolina Budget and Control Board reorganized the Employee Insurance Programs. This reorganization, however, did not become effective from an accounting and budgetary basis until July 1, 2002.

The Employee Insurance Programs Fund (EIP) was transferred to the Division of Insurance and Grants Services. The Seniors’ Drug Program was transferred to the Department of Health and Human Services. However, EIP will be acting as the administrator for this program. In this capacity, EIP will process and pay claims and receive reimbursement from the Department of Health and Human Services for these claims.

## OTHER FINANCIAL INFORMATION

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAMS FUND

STATEMENT OF EXPENDITURES-BUDGET AND ACTUAL  
ALL BUDGETED FUNDS

YEAR ENDED JUNE 30, 2002

	<b>Budgetary Special Revenue Fund</b>		
	<b>Legal Basis Budget</b>	<b>Actual on Budgetary Basis</b>	<b>Variance Favorable (Unfavorable)</b>
<b>Other budgeted expenses:</b>			
<b>Special items:</b>			
Tobacco Settlement	\$ 24,000,000	\$ 21,345,335	\$ 2,655,665
	<u>\$ 24,000,000</u>	<u>\$ 21,345,335</u>	<u>\$ 2,655,665</u>

*See accompanying notes.*

INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL

**DeLOACH & WILLIAMSON, L.L.P.**  
**CERTIFIED PUBLIC ACCOUNTANTS**  
1401 MAIN STREET, SUITE 660  
COLUMBIA, SOUTH CAROLINA 29201

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**INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL**

Mr. Thomas L. Wagner, Jr., CPA  
State Auditor  
State of South Carolina  
Columbia, South Carolina

Dear Mr. Wagner:

We have audited the financial statements of the South Carolina State Budget and Control Board, Employee Insurance Programs (the "Fund") as of and for the year ended June 30, 2002, and have issued our report thereon dated September 25, 2002. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these combined financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the combined financial statements are free of material misstatement.

The management of the Fund is responsible for establishing and maintaining internal control. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control policies and procedures. The objectives of internal control are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of combined financial statements in accordance with accounting principles generally accepted in the United States of America. Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of internal control to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

In planning and performing our audit of the financial statements of the Fund for the year ended June 30, 2002, we considered its internal control in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control. Accordingly, we do not express such an opinion or provide such assurance. With respect to the internal control, we obtained an understanding of the design of relevant policies and procedures and whether they have been placed in operation, and we assessed control risk.

We noted certain matters involving the internal control structure and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention related to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect the entity's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements.

Our consideration of the internal control would not necessarily disclose all matters in the internal control components that might be material weaknesses under standards established by the American Institute of Certified Public Accountants. A material weakness is a condition in which the design or operation of one or more of the specific internal control does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the combined financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. However, we noted the following matter involving internal control and its operation that we consider to be a material weakness as defined above.

During 2001/2002, the Employee Insurance Programs Fund reported an increase in net assets of \$6,085,825. This income, along with losses in recent years, has resulted in liabilities exceeding assets of \$63,952,116 for the Fund at June 30, 2002. Additionally, Section 1-11-710(A)(4) of the South Carolina Code of Laws, 1976, as amended, stipulates that "a reserve equal to not less than an average of one and one-half months' claims must be maintained in the accounts and all funds in excess of the reserve must be used to reduce premium rates or expand benefits as funding permits." Under Proviso 63.15 the reserve requirement was changed. The Proviso reads "Notwithstanding any other provision of law, the State Health Plan is only required to seek a zero day reserve fund by the end of calendar year 2002. Although certain changes in the funding and coverages have taken place, there is no guarantee that the Fund will return to a surplus position or that cash will be adequate to cover claims and administrative costs. Additional funding sources, such as further rate increases, State appropriations, etc. may be necessary to provide for the costs of the continued existence of the Plan.

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This report is intended solely for the information of the State Auditor, management and others within the Organization and is not intended to be and should not be used by anyone other than these specified parties.

We would be pleased to discuss the above matters or to respond to any questions, at your convenience.

*Deloitte & Williamson, C.L.P.*

September 25, 2002